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WILLIAM W. BRATTON

Lyondell: A Note of Approbation

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I. INTRODUCTION

The Delaware Supreme Court inadvertently summoned the good faith genie out of the lamp in *Brehm v. Eisner*.¹ It there affirmed the Chancery Court's decision to dismiss the original complaint in the shareholders' derivative action in respect of the hiring and dismissal of Michael Ovitz by The Walt Disney Company. But it also granted leave to replead, noting "concerns about lavish executive compensation and our institutional aspirations that boards of directors of Delaware corporations live up to the highest standards of good corporate practices."² The Disney plaintiffs would indeed replead. The Delaware courts have been trying to get the genie back into the lamp ever since.³

Lyondell Chemical Company v. Ryan, a merger case, completes the job for now.⁴ It also diminishes the intensity of scrutiny of target boards under the rubric of *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*⁵ For one, the other, or both reasons, *Lyondell* will have more than its share of critics. But a note of approbation will be entered here. The current controversy regarding the good faith duty poses the question whether the fiduciary standard of conduct should be brought into congruence with prevailing standards of best practice, merging the soft law of corporate governance into the hard law of fiduciary duty. The Delaware courts have declined to effect the merger for two compelling reasons. First, the Delaware courts are not institutionally positioned to impose a liability standard directly grounded in best practices. Such a heavy duty liability regime, quite simply, lies outside of their job description. Second, even if the Delaware courts were institutionally positioned to impose such a standard, the policy case for doing so is unpersuasive. Big stick fiduciary liability presumably would serve the deterrent purpose of forcing corporate boards to follow best practices. Yet best practices have become deeply rooted in the fabric of corporate decision-making, including boardroom processes respecting mergers, without the additional prod of a liability stick. It is accordingly difficult to project that a liability regime based on best practices has a productivity-enhancing role to play.

Part II describes a continuing tension in Delaware fiduciary law between best practices as articulated in informal conversations within the corporate governance community and their place in the standard of conduct imposed in litigated cases. On the one hand, Delaware articulates a process jurisprudence on which best practices professedly come to bear. On the other hand, imposing best practices directly in cases holds out too strict a standard of liability in Delaware's institutional context. The Delaware courts mediate these tensions over time without necessarily resolving

1. 746 A.2d 244 (Del. 2000) (affirming dismissal of derivative complaint against Walt Disney board but without prejudice).
2. *See id.* at 248–49.
3. *See In re Walt Disney Derivative Litig.*, 906 A.2d 27 (Del. 2006) (affirming judgment for the defendants); *Stone v. Ritter*, 911 A.2d 362 (Del. 2006) (categorizing the good faith duty under the duty of loyalty).
4. 970 A.2d 235 (Del. 2009), *rev'd* C.A. No. 3176-VCN, 2008 WL 2923427 (Del. Ch. July 29, 2008).
5. 506 A.2d 173 (Del. 1985) (imposing a duty to auction the company in limited circumstances).

them definitively. Part II situates recent applications of the good faith standard in this larger context. It shows that even as levels of tension rose in the wake of Enron's collapse, institutional concerns ultimately prevailed when the Delaware courts confronted the tensions. The courts' refusal to adopt a more onerous standard of liability is unsurprising when viewed from this perspective.

Part III turns to the *Lyondell* case. In Delaware, sale of the company often triggers enhanced scrutiny of boardroom decision-making, and the *Lyondell* merger fell into the enhanced scrutiny category. Yet, in *Lyondell*, the Delaware Supreme Court took the occasion to relax the applicable standard of review, using the good faith duty as the doctrinal means to the end. Part III explains the case's surprising doctrinal twist by reference to its facts. Even as the board of directors in question arguably failed to follow the book of best practices, it did so in pursuit of a good deal, a deal that looks all the better in retrospect. Part III goes on to show that selling shareholders generally tend to get a good deal. The system long has been stacked in their favor, a posture unlikely to change in the wake of *Lyondell*'s more relaxed standard of review. If there remain policy problems respecting mergers and acquisitions to be addressed by fiduciary law, levels of premiums paid to selling shareholders are not among them.

II. BEST PRACTICES, LIABILITY STANDARDS, AND THE DELAWARE COURTS

This Part describes the institutional context in which the Delaware courts frame liability standards. The discussion, drawing on Melvin Eisenberg's distinction between standards of conduct and standards of review, poses that a strict standard of conduct is articulated as soft law in the world of corporate governance and that the soft law standard of conduct coexists in tension with the lesser standard of review articulated in case law. The Delaware courts undertake the difficult task of mediating between the high and low standards. In so doing, they tend to adhere to a lesson learned in history—the high side holds out more institutional danger than does the low.

A. *The Institutional Posture*

Professor Melvin Eisenberg offers a theory of the corporate law duty of care that poses a distinction between the standard of conduct and the standard of review.⁶ Eisenberg's standard of conduct is exacting, comprised of tort concepts like reasonable care and ordinary prudence, concepts that hold out the possibility of second guessing of corporate business decisions by an ex post finder of fact. The standard of review is slack, proceeding at the level of Delaware's classic triad,⁷ combining a duty to inform oneself, transactional disinterest, and good faith. In Eisenberg's description, corporate actors are inspected under the lesser standard of review. In most cases they pass. But, in the rare event they fail inspection, the greater standard of conduct comes crashing down on them. Significant liability can follow.

6. See MELVIN ARON EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS: CASES AND MATERIALS 539–44 (9th ed. unabridged, Foundation Press 2005) (1940).

7. See *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993).

Eisenberg's description does not quite track the law as laid out in the cases.⁸ But it nonetheless holds out an important insight respecting corporate fiduciary law. The fiduciary standard of conduct does indeed operate at two levels—a greater and a lesser, a higher and a lower. The higher standard, conceived by Eisenberg in terms of tort concepts, is more particularly articulated in the world of practice on the pages of an expanding book of corporate best practices. The lower standard is the duty articulated in the Delaware cases, in particular the standards applied when a plaintiff poses a case under the duty of care or the duty of good faith. The two standards coexist in an uneasy relationship. Delaware courts, even as they, in terms, apply the lesser standard, are acutely aware of the greater. Their decisions mediate between the two.

The best practices that comprise the higher standard are articulated in the multi-sided and informal world of self-regulation, that vaguely defined space in which governance experts make pronouncements about how things ought to be done. Some of the experts are professional governance intermediaries. Others are lawyers, business people, regulators, corporate law academics, number crunchers from business faculties, and judges, including the members of the Delaware bench. The experts engage in an ongoing conversation in a global framework. As the conversation is informal and self-regulatory, no official book of best practices results. The New York Stock Exchange's *Listed Company Manual* comes closest, but even its long list of corporate governance standards⁹ would have to be deemed incomplete. The syllabus of a director education program would provide an overview of the supplemental learning. But, because the articulation of best practices is as much a function of actions taken in practice as it is a matter of book learning or formal lawmaking, one accesses the cutting edge by observing governance at the front lines. There one will see notions of best practice informing the advice of counsel advising a board of directors or special committee about the best way to move a matter forward. Alternatively, one could look at the content of recent shareholder proposals on governance matters and the voting recommendations of proxy advisory services. Add up all of the sources and there emerges a set of norms that evolves dynamically, a very soft body of soft law.

Delaware's judges are focal point members of the international governance network and use their prominent position to articulate the case for Delaware incorporation and dispute resolution. They explain that they act in a mediative capacity, pursuing the state's interest in balancing conflicting interest group demands. And they take care to point out that they not only mediate between management and shareholders, but protect corporate risk takers against second-guessing of business decisions even as they simultaneously impose ethical constraints. They also emphasize

8. However, traces of it can be found in the ALI Principles. AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE §§ 4.01 (a), (c) (1995).

9. NYSE Euronext, Inc., *Listed Company Manual* § 303(A) (2009), available at <http://nysemanual.nyse.com/lcm>.

the importance of best practices. Follow the book of best practices, they tell the business people, and all will be well in the space Delaware provides for you.¹⁰

This “all will be well” message makes Delaware’s judges our enforcement system’s good cops, as opposed to the bad cops at the Securities and Exchange Commission (SEC) and the U.S. Attorney.¹¹ But good cop is not always an easy role to play. It’s one thing to talk about best practice at a corporate governance conference, and quite another to frame a liability standard in a litigated case. Constraints apply in the latter venue. From one side, the charter competition system holds out a threat of reincorporation outward or, short of that, legislative intervention from within the state should the courts slam down too hard with a liability standard. On the other side, perceived laxity could excite a preemptive response from the U.S. Congress, or, short of that, impair the Delaware bench’s reputation in the governance network.

The Delaware courts are adept at charting a path between the two constraints. They do indeed hold business actors to mandatory standards of conduct, but with a gentle touch. They take care to be prospective when tightening the standards.¹² Large money judgments are unlikely to be imposed.¹³ The Delaware courts maintain a profile as enforcers even so, deploying injunctive remedies against pending transactions and taking advantage of the litigants’ incentive to settle.¹⁴

The Delaware courts rely on heavily process-based standards of conduct as they acquit themselves of this difficult assignment. They started down this road thirty years ago, when freeze-out mergers of minority shareholders of subsidiary companies were a flashpoint issue and it looked for a moment like the SEC might come in and preempt some of Delaware’s substantive turf.¹⁵ Responding, the Delaware courts abandoned a long-held laissez faire posture respecting these mergers and instituted fiduciary review.¹⁶ But this lurch to substantive scrutiny implied a parade of messy litigations over price fairness that would put the Delaware courts in an awkward, deal obstructive position. They found their way out of that uncomfortable corner in *Weinberger v. UOP*.¹⁷ *Weinberger* made a process move, suggesting that full dress

10. See E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992–2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1404–07 (2005).

11. William W. Bratton & Joseph A. McCahery, *The Equilibrium of Corporate Federalism*, 41 WAKE FOREST L. REV. 619, 685–86 (2006).

12. See Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1023–39 (1997).

13. *Id.* at 1089.

14. For a prominent exemplar of the role of settlement in the articulation of Delaware’s fiduciary jurisprudence see *infra* notes 16–18 and accompanying text discussing *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996) (enunciating an important new fiduciary rule in the context of review of a settlement that provided no money damages).

15. See Bratton & McCahery, *supra* note 11, at 679–85.

16. *Singer v. Magnavox Co.*, 380 A.2d 969, 980 (Del. 1977).

17. 457 A.2d 701 (Del. 1983).

scrutiny could be avoided if the subsidiary board deployed a special committee of independent directors to negotiate a fair price with the majority shareholder parent. Corporations readily accepted the invitation. The Delaware courts, as a result, could side-step substantive review and drop to the secondary position of reviewer of the process employed, looking not to the deal's substantive fairness but to the viability of the negotiating structure. It was a moment of genius and it transformed corporate fiduciary law.

Once the inquiry goes to process, the book of best practices provides an obvious source of content. Indeed, if one restricts one's view to cases where a process is employed to work around a conflict of interest problem—the various going private fact patterns provide the primary exemplar—something very close to strict adherence to best practices is the Delaware rule.¹⁸ A question arises: If adherence to best practices makes sense in one class of case, why not impose it across the board? In a fiduciary regime grounded in process, how can anything short of best practices be defended as the standard of conduct? An affirmative answer sounds good in the abstract. But it will sound much less good to a Delaware judge looking to maintain a balance between solicitude of legitimate business interests and enforcement credibility.

B. From Van Gorkom and 102(b)(7) to Disney and Good Faith

It is particularly difficult to balance solicitude of business interests and enforcement credibility when a breach of duty of care is alleged in respect of a completed transaction, a class of case in which a gentle but plausible result is hard to finesse. Instances of departure from the book of best practices are not hard for plaintiffs to find in respect of boardroom processes at merger targets. Thus have the Delaware courts seen litigation after litigation in which a plaintiff claims that a best practice defalcation, taken alone, supports a case for liability on duty of care or, alternatively, good faith grounds.

*Smith v. Van Gorkom*¹⁹ was the first case in this sequence. There, the Delaware Supreme Court famously imposed duty of care liability on a board of directors in respect of a decision to sell the company, a result no one in the business community expected. The result was a rupture in the market for director and officer liability insurance policies, with coverage availability constrained in the short run and premiums increased in the long run.²⁰ These costly developments injured Delaware's reputation for stability and business solicitude. There resulted an important lesson for the Delaware courts: merging the lesser, legal standard of conduct into the greater standard embodied in the book of best practices results in too wide an ambit of liability. The Delaware legislature underscored the lesson when it added section

18. See, e.g., *In re Topps Co. S'holders Litig.*, 926 A.2d 58 (Del. Ch. 2007) (reviewing a going private process).

19. 488 A.2d 858 (Del. 1985).

20. See, e.g., Randy J. Holland, *Delaware Directors' Fiduciary Duties: The Focus on Loyalty*, 11 U. Pa. J. Bus. L. 675, 691–92 (2009).

102(b)(7) to the Delaware General Corporation Law,²¹ permitting companies to opt out of the duty of care in their charters. When company after company thereafter chose to opt out, the implication arose that the shareholders ratifying the charter amendments did not view a fiduciary regime grounded in strict adherence to best practices as cost beneficial.

Section 102(b)(7), enacted to unwind the effects of a judicial decision mandating best practices, brings us to the good faith duty. Good faith rose to doctrinal prominence because section 102(b)(7) cordoned it off, along with the duty of loyalty, against opt out. But what did good faith mean? Even as the concept clearly had deep corporate law roots, there was no more particular explication to provide guidance.²² It appeared in several important sections of the Code—in section 144, addressed to the approving disinterested directors;²³ in section 141(h), addressed to directors relying on reports prepared by subordinates;²⁴ and in section 145, addressed to indemnitees.²⁵ Good faith also had shown up in a couple of prominent cases,²⁶ the most interesting of which for present purposes was *Cheff v. Mathes*,²⁷ the predecessor to *Unocal Corp. v. Mesa Petroleum Co.*²⁸ *Cheff* drew on good faith as the standard of review for antitakeover tactics. The effect was to broaden the zone of discretion for defending managers: good faith review meant that Delaware would not be reviewing tender offer defensive tactics as conflict of interest transactions; *Cheff* closed off reference to classic fairness review under the duty of loyalty, which presumably would have been more exacting. The good faith inquiry the case instituted was subjective but not searching—the board needed to show its fidelity to the corporation’s best interests by identifying a “threat.” A minimal process jurisprudence resulted. A board of directors defending against a hostile offer would act out a kabuki play directed by a lawyer like Joseph Flom or Martin Lipton. The drama turned on a formal report that identified a threat to the corporation. Under the standard of review, the report objectively verified the defending board’s subjective pursuit of the corporation’s best interests.²⁹ No more of a defense was needed, even if the motivating purpose, objectively and subjectively, was entrenchment. Good faith, in short, was not about best practices.

21. DEL. CODE ANN. tit 8, § 102(b)(7) (2001) (permitting opting out of personal liability of directors for duty of care violations).

22. For a history of the good faith concept, see Leo E. Strine, Jr., *Loyalty’s Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L.J. 629 (2010).

23. DEL. CODE ANN. tit 8, § 144 (2001).

24. *Id.* § 141(e).

25. *Id.* § 145.

26. See, e.g., *Guth v. Loft*, 5 A.2d 503 (Del. 1939). Delaware’s leading statement of the corporate opportunity doctrine provides a good example. The phrase shows up in the case, but without any notable subsequent consequences for the formulation of the duty of loyalty.

27. 199 A.2d 548 (Del. 1964).

28. 493 A.2d 946 (Del. 1985).

29. See, e.g., Stephen M. Bainbridge, *Unocal at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769, 792–93 (2006).

But section 102(b)(7) had created a pressure point, and the Delaware courts, as ever, were balancing competing demands. Even though the evolving book of best practices would not be dictating Delaware's standard of conduct,³⁰ the Delaware bench still needed to keep the book open and stay apprised of developments toward the end of maintaining a credible fiduciary regime. And, even as corporations now could opt out of the duty of care, that credible fiduciary regime still had to deal with questionable results and practices brought to light by high-profile litigation outside of classic conflict of interest territory.

Thus did *In re Caremark International Inc. Derivative Litigation*³¹ overrule *Graham v. Allis-Chalmers*³² from below. Under *Graham*, a 1963 decision of the Delaware Supreme Court, the duty of care implied no obligation proactively to detect legal compliance failures within the business operation. In *Caremark*, the Delaware Chancery Court mandated a duty to monitor legal compliance in direct contradiction of *Graham*, the prevailing ruling of its own higher court. But outside developments respecting best practices provided an ample justification for the act of insubordination. By 1996, when *Caremark* was decided, *Graham's* lax formulation long had been superseded in the real world, where internal legal compliance systems had emerged with a prominent place in the book of best practices. The Chancery's new duty, eventually relocated in the good faith tent, would be cheerfully ratified by the Delaware Supreme Court a decade later in *Stone v. Ritter*.³³

Caremark and *Stone* show that the evolving book of best practices can impress itself directly on Delaware's fiduciary standards. Compliance systems, once optional, all of a sudden became mandatory, with the courts sidestepping section 102(b)(7) by drawing on the good faith concept as the mandate's basis.

But Delaware carefully distinguishes the greater from the lesser even here: *Caremark's* standard of review does not ask for much when it pegs liability on an "utter failure" to assure a reasonable information and reporting system. The Sarbanes-Oxley Act (SOX)³⁴ drove home that point—its section 404³⁵ subsumed best practices with respect to compliance into a federal mandate. *Caremark's* standard, although notable in the context of the evolution of corporate fiduciary law, quickly became close to irrelevant in practice. Meanwhile, the moaning and groaning in the business community that greeted SOX section 404³⁶ reminded Delaware of the need to continue to attend to cost sensitive constituent interests.

30. See *Brehm v. Eisner*, 746 A.2d 244, 255–56 (Del. 2000) (noting that best practices are not the law).

31. See *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 969–70 (Del. Ch. 1996).

32. 188 A.2d 125, 130–31 (Del. 1963).

33. 911 A.2d 362, 369 (Del. 2006).

34. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified throughout Titles 11, 15, 28, and 29 of the U.S.C.).

35. *Id.* at § 404, 116 Stat. at 789 (codified at 15 U.S.C. § 7262 (2006)).

36. See, e.g., Roberta Romano, *Does the Sarbanes-Oxley Act Have a Future?*, 26 YALE J. ON REG. 229, 239–44 (2009) (discussing reconsideration of section 404 as applied to small businesses).

Maintaining the balance proved particularly difficult in the post-Enron environment that precipitated SOX. Best practices emerged in the popular imagination as a one-size-fits-all cure for corporate ailments. Delaware professedly stands for best practices, but always has preferred to leave particulars respecting adoption to the corporations themselves.³⁷ SOX, together with a longer list of best practice mandates adopted by the New York Stock Exchange,³⁸ implied that Delaware was erring on the side of laxity.

The Walt Disney litigation went to trial in the midst of all the heat.³⁹ Here was Michael Eisner, the most imperial Chief Executive Officer (CEO) of the era, paying Michael Ovitz, a tinsel town huckster, \$140 million just to leave the building. Yet Disney's board of directors failed to pay the slightest obeisance to the book of best practices either when it adopted the employment contract that gave Ovitz the right to the \$140 million exit jackpot, or when it supervised the termination of Ovitz's employment at the jackpot price.⁴⁰ Maybe it made sense to use the good faith duty as a vessel for smuggling the duty of care back into the tent and forcing adherence to best practices into the bargain.

Thus did *Disney* pose the choice between the greater and the lesser in the post-Enron environment. On the one hand, good faith pursuit of the corporation's best interests could be merged into adherence to the book of best practices under a ramped up standard of review. On the other hand, practice niceties could be relegated to the status of factors to be considered in a more open-ended judicial inquiry. What made *Disney* exceptional was active possibility that the Delaware courts might take a step in the direction of the greater standard. Their ultimate refusal to do so was unsurprising in view of their historic aversion to per se fiduciary standards.

In any event, the courts' definition of good faith as the pursuit of the corporation's best interests does not and cannot make the book of best practices irrelevant, especially when the company is being sold. *Smith v. Van Gorkom* thus continues to stand for the proposition that best practices matter when a board sells the company pursuant to a merger agreement. An independent line of duty of loyalty cases that begins with *Revlon* and matures in *Paramount v. QVC*⁴¹ stands right there with *Van Gorkom*. These cases demand active pursuit of the best price by a subset of selling companies, holding out the book of best practices as a fiduciary guide under the rubric of "enhanced scrutiny."⁴² But even here the Delaware courts have remained

37. Cf. E. Norman Veasey, *An Economic Rationale for Judicial Decisionmaking in Corporate Law*, 53 BUS. LAW. 681, 699–700 (1998) (describing the precatory nature of proposed aspirational norms).

38. See NYSE Euronext, Inc., Listed Company Manual §§ 303A.00–.07 (2009), available at http://nysemanual.nyse.com/LCMTTools/bookmark.asp?id=sx-ruling-nyse-policymanual_303A.00&manual=/lcm/sections/lcm-sections/ (requiring listed companies to have a majority of independent directors and requiring certain committees having independent directors as members).

39. See *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006).

40. See *id.* at 56–57 (describing what adherence to best practice implied on the facts of the case).

41. 637 A.2d 34 (Del. 1994).

42. *Id.* at 43–44; see, e.g., *Smith v. Van Gorkom*, 488 A.2d 858, 874–81 (Del. 1985).

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wary of particularized mandates, telling us in *Barkan v. Amsted Industries, Inc.*⁴³ that *Revlon* inspection means principles and factual complexities rather than per se rules.

III. LYONDELL

*Lyondell Chemical Company v. Ryan*⁴⁴ brings the good faith standard of conduct and *Revlon* scrutiny to the same fact pattern, and pointedly moves scrutiny of friendly mergers away from the greater in the direction of the lesser. Section A dissects the case, Section B defends the result on the facts, and Section C concludes by adding a policy justification.

A. *The Lyondell Merger and the Delaware Litigation*

Lyondell was a chemical company whose sector was experiencing a wave of acquisition activity. Its board of directors was not looking to sell, but also not averse to a good deal.⁴⁵ A private equity shop had proposed a leveraged buyout, but Lyondell's CEO would have none of it, professedly because such deals are too conflicted.⁴⁶ Then a bidder satisfactory to the CEO did materialize. This was Basell AF, a European producer descended from a joint venture founded in 2000 between Royal Dutch Shell and BASF. Basell was in turn owned by Access Industries, a diverse group of companies that includes large Russian oil and aluminum producers and some of the fanciest hotels in South America, all under the control of Russian-born billionaire Len Blavatnik.⁴⁷

Basell and Lyondell closed on a friendly deal at \$48 per share in cash, negotiated up from \$40 by Lyondell's CEO. The plaintiff, a Lyondell shareholder, cited a pattern of inactivity on the part of the Lyondell board in the weeks preceding the merger, alleging bad faith. A good faith board, said the plaintiff, would have scared up more money.⁴⁸ There was no self-dealing on the fact pattern. In addition, Lyondell had a 102(b)(7) provision opting out of the duty of care. The case accordingly was framed to combine *Revlon* as the standard of conduct, a cash sale being a *Revlon* trigger event, along with good faith as the standard of review.

Vice Chancellor Noble denied the Lyondell board's motion for summary judgment. He acknowledged the attractiveness of the \$48 price,⁴⁹ even as he held open the possibility that bad faith could be found on the facts.⁵⁰ But price fairness

43. 567 A.2d 1279, 1286 n.2 (Del. 1989).

44. 970 A.2d 235 (Del. 2009), *rev'g* C.A. No. 3176-VCN, 2008 WL 2923427 (Del. Ch. July 29, 2008).

45. *See Lyondell*, 970 A.2d at 237–38.

46. *Lyondell*, No. 3176, 2008 WL 2923427, at *5.

47. ACCESS INDUSTRIES, *About the Company*, <http://www.accessindustries.com/about.html> (last visited Sept. 21, 2010).

48. *Lyondell*, 970 A.2d at 239.

49. *Lyondell*, No. 3176, 2008 WL 2923427, at *13–14.

50. *Id.* at *3.

and bad faith make for an uneasy combination: If the price was attractive, how could the board not be acting in the company's best interests? The key, for Vice Chancellor Noble, lay in his finding that the Lyondell board had crossed the border into *Revlon* territory (and its duty actively to pursue the best price) at the time that Blavatnik purchased an option on an eight percent stake in Lyondell owned by Occidental Petroleum. This, noted the Lyondell board at the time, put their company in play.⁵¹

But it was a tentative state of play. The Lyondell board, even as it found itself in play, hewed to the view the company was not for sale. Meanwhile, even as the purchase of the option indicated considerable interest in Lyondell on Blavatnik's part, that interest was contingent. Blavatnik already had entered into a merger agreement with Huntsman Corporation, the closing of which implicitly precluded acquisition of Lyondell. Blavatnik's Huntsman deal was not a sure thing despite the merger agreement. A topping bid that would undercut the agreement had emerged from a third party and Blavatnik was deciding between upping his own bid and walking away. He looked at Lyondell as a back up deal in the event he determined to walk.

The option purchase date fell two months before Blavatnik finally came out of the woodwork to make an offer for Lyondell, an event that occurred even as the Huntsman agreement remained in force. No matter, said the Chancery court. Once *Revlon's* value maximization directive applied, the Lyondell board was supposed to pursue a sale actively, even though it had made an affirmative decision not to do so. It failed to hustle and so was found in bad faith, even though the \$48 paid was thought to be a good price.⁵²

The Chancery opinion slams down the book of best practices, enumerating various process roads that the Lyondell board might have taken. It might have conducted an auction, shopped the company, or immediately retained an investment bank so as to have a solid basis for making any later valuation judgments. The fact pattern of a precedent single-bidder case, *In re Pennaco*,⁵³ is held out as a practice template against which the Lyondell board should have measured up: Where, says the court, was the pitch book? Where was the board's pushback against Blavatnik's bid? The Chancery also pumps up the good faith standard for the *Revlon* context, applying an objective standard of review and holding the Lyondell board to have failed to use reasonable efforts to create value. It was the greater rather than the lesser.

The Delaware Supreme Court, reversing, proved much less *Revlon* trigger-happy than the Chancery, moving the *Revlon* start two months later than the date identified by the Chancery Court to the date when Blavatnik actually made an offer.⁵⁴ The date shift compressed the period of intensive review to around a week. Fault is found—the court suggested that absent the 102(b)(7) provision in Lyondell's charter there might be reason to deny defendant's motion for summary judgment and inquire into a duty of care

51. *Id.* at *2.

52. *Id.* at *16–18.

53. *In re Pennaco Energy, Inc. S'holders Litig.*, 787 A.2d 691 (Del. Ch. 2001).

54. *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 242 (Del. 2009).

violation.⁵⁵ But, said the court, less is demanded under good faith. It is not a standard that requires the board to do everything that it might have done, requiring only a knowing and complete failure to undertake responsibilities. Borrowing from *Caremark* and *Stone*, the court called for an utter failure to attempt to obtain the best sale price⁵⁶—the lesser rather than the greater. It also pointedly rejected the idea that directors should be held to follow particular prescriptions in the best practices playbook. *Barkan* had rejected the proposition that *Revlon* entailed a per se procedure; there accordingly were no specific steps the directors could be held to have failed to undertake.

Thus did the Delaware Supreme Court confirm the astuteness of Eisenberg's analysis. *Lyondell* explicitly separates the standard of conduct and the standard of review. The former remains the duty to get the best price descended from *Revlon* and *QVC*, with the reviewing court bringing to bear only the lesser "utter failure" standard. The bifurcated treatment much reduces the intensity of *Revlon*'s enhanced scrutiny, at least where, as in *Lyondell*, no directoral self-dealing appears on the facts.

The new standard's formulation will trouble many observers. Left to my own devices I would not have used *Caremark*'s "utter failure" phrase even as I would have ruled in the *Lyondell* board's favor. But I doubt that the choice of phrasing holds out perverse effects for the future. When a case comes up with a supine board and value manifestly going up in smoke, the Delaware courts will know what to do and find a way to do it within *Lyondell*. Indeed, the case's one-week deal sequence roughly matches the scenario I pose to my students when wrapping up discussion of *Smith v. Van Gorkom*. That case makes a friendly transaction with a partner selected by the CEO impossible on an accelerated two- or three-day timetable. So I pose a narrow reading of *Van Gorkom* and ask how quickly one could get a selling board to approve a merger agreement with an impatient bidder making an attractive bid. So long as an investment banker answers an immediate summons, the company should be able to get its ducks lined up in a week or so, albeit with a possible lawsuit to follow. Or so I tell my students. Thus invested, I like the court's confirmation of my reading.⁵⁷

B. The Facts of the Case

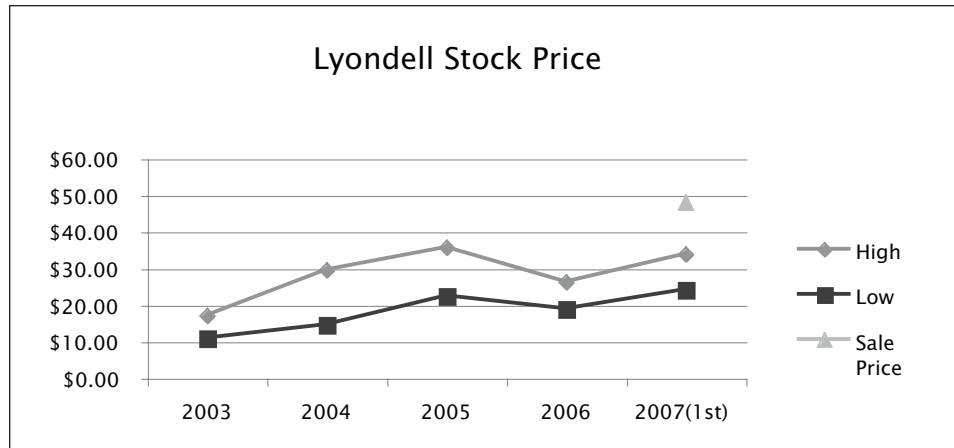
More importantly, I think the result is absolutely right on the facts. It *was* a good deal. There is something unseemly about the shareholder whining one hears here. Blavatnik went up to \$48 on a best-offer basis and stuck with the number. The plaintiffs responded, "Well, couldn't the *Lyondell* board just push back?" Well, maybe the board was playing cautiously in view of its bidder's recent behavior. Blavatnik had just been topped by a small amount at Huntsman. He had thought about topping the topping bid for a while and decided he was not going to offer another penny. The *Lyondell* board accordingly had reason to believe they were dealing with someone who held his ground once he fixed his price.

55. *Id.* at 243.

56. *Id.* at 244.

57. The duty of care violation mentioned by the court is dictum.

Figure I



In any event, these shareholders whined all the way to the bank at \$48. Figure I shows Lyondell stock's highs and lows through the first quarter of 2007—that is, through the last quarter before the company was put “in play.”⁵⁸ The stock had been backing and filling; with \$33.90 the most recent high, \$48 had to look good.

Below are some glimpses of the merger partners in 2006.⁵⁹ Table I looks at income. Both companies end up at roughly comparable \$/€ 500 million bottom lines after paying their interest, but margins of revenues to out of pocket operating costs are not wide in either case. Turning to the balance sheets in Table II, we see that Basell is a much smaller company, with a higher return on assets. Both companies had a lot of

Table I

LYONDELL AND BASELL 2006 — INCOME			
Lyondell (USD)		Basell (Euro)	
Revenues	\$ 21 billion	Revenues	€10.4 billion
Costs	20	Costs	9.7
Operating income	1.1	Operating income	.7
Interest expense	.6	Interest expense	.2
Net income	\$.5 billion	Net income	€ .5 billion

58. Lyondell Chemical Co., Schedule 14A, at 66, Oct. 12, 2007, <http://www.sec.gov/Archives/edgar/data/842635/000084263507000073/lyodefm14a-101207.htm>; Lyondell Chemical Co., Form 10-K, at 48, Feb. 28, 2007, <http://www.sec.gov/Archives/edgar/data/842635/000119312507042792/d10k.htm>; Lyondell Chemical Co., Form 10-K, at 48, Mar. 16, 2005, http://www.sec.gov/Archives/edgar/data/842635/000119312505052566/d10k.htm#tx86106_57.

59. Lyondell Chemical Co., Form 10-K, Feb. 2, 2007, <http://www.sec.gov/Archives/edgar/data/842635/000119312507042792/d10k.htm>; Lyondell Basell Industries AF S.C.A. Consolidated Financial Statements 2007 (on file with author).

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Table II

LYONDELL AND BASELL 2006 — BALANCE SHEETS			
Lyondell (USD)		Basell (Euro)	
Total assets	\$17.8 billion	Total assets	€ 7.4 billion
Borrowing	8	Borrowing	3.1
Shareholders' equity	3.2	Shareholders' equity	1.3

Table III

TIME LINE 2007	
Lyondell	Economy
	April – New Century Financial goes bankrupt
May – in play	
	June – Bear Stearns hedge funds implode
July – merger agreement signed	
	August – Federal Reserve and European Central Bank take liquidity action
	October – Citibank, Merrill Lynch, and UBS take write-downs on portfolios of debt securities
November – merger closes	

debt, and Basell was planning to fund the cash consideration for the merger with more borrowing. An implication of vulnerability arises from the numbers.

Going back to the facts of the case after looking at these financials makes the Lyondell board look all the more reasonable. It made sense to move quickly and close the deal before something spooked Blavatnik. A judgment call had to be made. The lesser standard allows the court to take the uncertainties into account. Review the same facts under the book of best practices and you get a very different answer.

Subsequent events bear out the board's decision. The Lyondell shareholders got their deal even as the economy was starting to melt down. Table III lists some events in the sequence of economic collapse.⁶⁰ Blavatnik signed a Lyondell merger agreement without financing conditions. Before the deal was closed, the pipeline of corporate loans dried up, putting a stop to new private equity deals. Meanwhile, Huntsman got its topping bid only to proceed to a nasty litigation with a merger partner trying to back out as the economy tanked.⁶¹

60. See VIRAL A. ACHARYA & MATTHEW RICHARDSON, RESTORING FINANCIAL STABILITY 51 (2009).

61. See *Hexion Specialty Chem., Inc. v. Huntsman Corp.*, 965 A.2d 715 (Del. Ch. 2008).

Blavatnik funded the November closing with bank borrowing. For whatever reason (perhaps covenants in Basell's loan agreements), Basell borrowed the money and then reloaned it to Lyondell. Basell's deal information sheet projected a ratio of EBITDA⁶² to interest charges of 2.3.⁶³ This is a tight ratio. Perhaps it was a viable projection in May 2007; as the year proceeded it must have looked less and less reachable.

Disaster struck soon enough. Most of the deal's financing came from bridge loans due in a year.⁶⁴ When the bridge loans came due, takeover financing did not materialize, credit having dried up. Table IV compares the consolidated company's 2007 and 2008 balance sheets to show the result.⁶⁵ The former Lyondell, now the American subsidiary of LyondellBasell, was in Chapter 11 by January 2009.⁶⁶ The parent, LyondellBasell, followed it into bankruptcy in April.⁶⁷

Table IV

LYONDELLBASELL (USD)			
2007		2008	
Total assets	39.7 billion	Total assets	28.6 billion
Current portion		Current portion	
long term debt	0.5	long term debt	22.9
Long term debt	21.5	Long term debt	0.3
Shareholders' equity	1.9 billion	Shareholders' equity	-6.1 billion

Lyondell's largest creditors were ABN Amro, Royal Bank of Scotland, and Citibank, or what was left of them. Blavatnik is still very much around despite his chemical companies' bankruptcies. He has been bottom fishing in the down economy, looking for new companies to buy, albeit much smaller ones.⁶⁸ He also has suffered

62. EBITDA is earnings before interest, taxes, depreciation, and amortization; it is a measure of cash flow.

63. Basell AF S.C.A., *Certain Information Relating to the Acquisition of Lyondell Chemical Company as of November 28, 2007*, at 17, <http://www.lyondellbasell.com/NR/rdonlyres/EDDE8F97-D3AA-4B64-BB64-F0A4671E5281/0/InformationregardingtheacquisitionofLyondell.pdf>.

64. *Id.* at 32.

65. See LyondellBasell Indus., *AF S.C.A. Consolidated Financial Statements Year Ended December 31, 2008, With Report of Independent Auditors*, at 4, <http://www.lyondellbasell.com/NR/rdonlyres/24C453F8-CAA2-4D9D-9EF4-73F7DE5D343B/0/2008LBFinancialStatements.pdf>. The numbers used in Table IV are rounded for viewing ease.

66. *LyondellBasell's U.S. Operations and One of its European Holding Companies File Chapter 11 to Restructure Balance Sheet*, LYONDELLBASELL.COM, <http://lyondellbasell.mediaroom.com/index.php?s=43&item=679> (last visited Sept. 23, 2010).

67. *LyondellBasell Adds Holding Company to Chapter 11 Protection*, LYONDELLBASELL.COM, <http://lyondellbasell.mediaroom.com/index.php?s=43&item=716> (last visited Sept. 23, 2010).

68. See, e.g., Ronald Grover & Michael White, *Billionaire Blavatnik Said to Join Bidding for MGM*, Bus. Wk. (Feb. 3, 2010, 8:29 PM), <http://www.businessweek.com/news/2010-02-03/billionaire-blavatnik-said->

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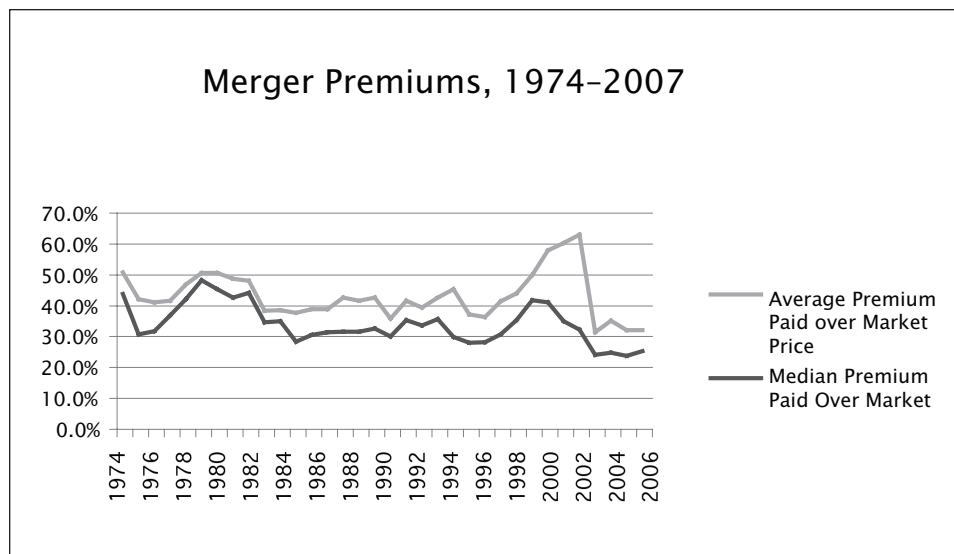
some losses on his investment portfolio, and so last June brought a lawsuit against JP Morgan Chase, accusing it of losing \$98 million after inappropriately investing his money in securitized subprime paper.⁶⁹ One suspects that the Lyondell merger agreement also takes a place on Blavatnik's list of regretted transactions. Amidst all the regrets and lawsuits, only one set of clear winners emerges—Lyondell's shareholders and their \$48 bird in the hand.

C. Policy

I turn finally to policy implications. The Lyondell board very well might have pulled in some more money. A question arises accordingly: Should not the law impose tight process requirements toward the end of forcing selling corporations to be seen to push hard to get top dollar for their shareholders, thereby providing a circumstantial guaranty that the sale price approaches the maximum available?

The answer to the question might be “yes,” if corporations were being sold with little or no premium over their stock prices. But such has not been the case. Indeed, corporate law has spent a great deal of energy over the past quarter century making sure that target companies do not get given away. Figure II depicts mean and median merger premiums from 1974 to 2007.⁷⁰

Figure II



to-join-bidding-for-mgm-update2-.html.

69. Zachery Kouwe, *Company Is Planning to Sue Chase Over Investment Losses*, N.Y. TIMES, June 21, 2009, at B2.

70. W.T. GRIMM & CO., MERGERSTAT REVIEW (Tomislava Simic 1982); W.T. GRIMM & CO., MERGERSTAT REVIEW 49 (Tomislava Simic 1983); MERRILL LYNCH BUSINESS BROKERAGE AND VALUATION, MERGERSTAT REVIEW 77 (1991); MERGERSTAT, MERGERSTAT REVIEW 24 (2001); FACTSET MERGERSTAT, MERGERSTAT REVIEW 24 (2008) (on file with author), available at <http://www.factset.com>.

The premiums are surprisingly stable, at least until the year 2000. The long stability is particularly impressive when the volatility of the overall merger market is recalled. Transaction volume peaked in the 1980s, bottomed out in the early 1990s, and then peaked again even as premiums stayed in the thirty to forty percent range. There was unusual volatility in premium levels after 2000. Premiums spiked upward against the background of a depressed stock market in the decade's early years, and then ratcheted down to historic lows.

A question arises as to whether corporate governance in target boardrooms had something to do with that decline in premium levels. The answer must be no. It is implausible to link market-wide price movement to boardroom practice. If anything, boards have been getting progressively more careful about their procedures across the entire period depicted in Figure II. The break in the pricing pattern more likely has to do with the relation of asset values to stock market prices and the prominence of private equity in the M&A market.

Another point about merger premiums should be noted. Within a given merger market, premiums tend to be stable across different industries and many types of transactions, but with two consistent exceptions. When the merger consideration is cash rather than bidder stock, the average premium goes up 8.6 percent; and, in an auction, the average premium goes up 11.4 percent.⁷¹ The Lyondell deal thus occurred in a high-paying sector (even if the board did not conduct an auction), and was high end at all events in the low premium market of 2007.

More importantly, the premium paid to the selling shareholders appears in most cases to be so substantial as to arrogate to them the entire merger gain. Studies of announcement period price effects bear out this assertion with a stark allocational picture. While target shares go up a consistent sixteen percent during the three days surrounding the announcement, bidder shares go down. The bidder share average decline was -0.3 percent in the 1970s, -0.4 percent in the 1980s, and -1.0 percent in the 1990s.⁷² Over a period of several months, target shares average an increase of 23.8 percent, while bidder shares on average go down around four percent.⁷³ The figures imply consistent losses to bidder shareholders, and a concomitant wealth transfer to selling shareholders.

There are various competing explanations for these allocational patterns. But they need not be assayed here. The numbers speak for themselves: selling shareholders do just fine in our legal system. There accordingly is no policy reason for Delaware to rejig its fiduciary law to make life easier for plaintiffs' lawyers who, despite the fact that money is raining down from the sky into the pockets of the company's shareholders, construct seductive cases from ex post second guessing what a target board might or "should" have done. At the same time, it is hard to see a cognizable

71. Robert Comment & G. William Schwert, *Poison or Placebo? Evidence on the Deterrence and Wealth Effects of Modern Antitakeover Measures*, 39 J. FIN. ECON. 3, 32 (1995).

72. Gregor Andrade et al., *New Evidence and Perspectives on Mergers*, 15 J. ECON. PERSP. 103, 109–10 (2001).

73. *Id.*

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governance problem under the prevailing standard of review, even in Lyondell's relaxed formulation. If there is a governance problem here, it lies not in the boardrooms of the selling corporations, but in those of the purchasing corporations.

IV. CONCLUSION

Soft law standards of corporate governance evolve in the context of the wider political economy, tightening in the wake of economic reverses and corporate scandals. The Delaware courts work through fiduciary issues against this backdrop. They tightened merger scrutiny when the market for corporate control heated up in the 1980s, only to loosen up a bit thereafter as boardroom practice adjusted to the new environment. Enron brought new pressure to tighten, and the Delaware courts worked through the issues raised in *Disney*. Their eventual decision to hew to their fiduciary tradition and avoid direct imposition of best practice makes sense in view of their experience, which teaches that neither managers nor actors in the capital markets look to Delaware to impose tight liability standards. *Lyondell* both reflects the overall pattern and confirms that the system remains in good working order.